

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 02-0334
Indiana Gross Retail Tax
For Tax Periods 1999-2000

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ISSUES

I. Gross Retail Tax—Manufacturing exemption

Authority: Ind. Code § 6-2.5-5-3; 45 IAC 2.2-5-8

Taxpayer argues that a crane, repair and maintenance parts for the crane, certain equipment used to remove non-ferrous items from metal, and various other items related to its operations are exempt as property used in production.

II. Tax Administration: Negligence Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the assessment of a negligence penalty.

STATEMENT OF FACTS

Taxpayer is a business engaged in receiving scrap metal from various sources. Basically, Taxpayer's operations work along these lines: a truck with potential metal for Taxpayer's use arrives at its facility. After weighing, the truck's cargo is then tested for radioactive material. If the material is not radioactive, it is then sorted by crane into metal type (or non-metal type), including a separate pile for certain items not capable of shredding. Any metals then have non-ferrous parts removed, and then the metal proceeds to ultimate shredding. The shredded metals are then sold to users that use the metal in the users' ordinary course of business.

Taxpayer was assessed use tax with respect to aforementioned crane, various items used in the maintenance and repair of the crane, along with other materials used in removing nonferrous materials from metals and cutting metals and items which were not assigned to specific expense accounts. Taxpayer has protested the assessment and resulting negligence penalties.

DISCUSSION

I. Gross Retail Tax—Manufacturing exemption

Taxpayer argues that a crane used for removing scrap metal from trucks, along with various welding and other materials used in removing nonferrous items from metal, are exempt from Indiana's gross retail (sales) tax as property used in the production of other tangible personal property.

Under Ind. Code § 6-2.5-5-3(b):

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

In addition, 45 IAC 2.2-5-8(c) states:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

Finally, 45 IAC 2.2-5-8(k) states:

“Direct production, manufacture, fabrication, assembly, or finishing of tangible personal property” is performance of a series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change, and it must result in a transformation of property into a different product having a distinctive name, character, and use. Operations such as compounding, fabricating, or assembling are illustrative of the types of operations which may qualify under this definition.

This test requires two steps: direct use and direct production of other tangible personal property. At this point, a series of questions must be addressed. What is the role of the equipment? Is this role an integral part of the process of producing tangible personal property? Is the property changed as a result of the equipment?

Taxpayer argues that the crane used in sorting various metals and other materials qualifies for exemption for use tax based on its use in the production of other tangible personal property. In particular, Taxpayer argues that its production process begins at the moment that Taxpayer tests incoming trucks for radioactivity.

Here, it is difficult to describe the role of the crane as a part of an integrated process that results in the production of other tangible personal property. Most instructive of various examples is 45 IAC 2.2-5-8(c)(4)(G) which states:

4) Because of the lack of an essential and integral relationship with the integrated production system in Example (1), the following types of equipment are not exempt:

(G) Equipment used to remove raw materials from storage prior to introduction into the production process or to move finished products from the last step of production.

The role of the crane is to pick out parts from a truck that would bring varied materials into Taxpayer's scrap yard, and then sorts the materials into acceptable items, unacceptable items, and items that require further work. The steps taken by Taxpayer at this point do not transform the metal as required by the regulation. Rather, the crane is moving the metal from storage-a delivery truck- to some future stage. This does not constitute part of an "essential and integrated relationship with the integrated production system". Until the metal is shredded or otherwise acted upon in a manner that otherwise transforms it, production has not begun. Accordingly, Taxpayer's protest is denied.

With respect to the various items used in maintenance of the crane, it is true that the repair and maintenance supplies for the crane are exempt from sales tax- if the crane is part of the process that produces other tangible personal property under 45 IAC 2.2-5-8(h)(2). Given that the crane is not used in the production of other property, the resulting repair and maintenance parts are not exempt.

With respect to the items used in removing nonferrous items from metal or cutting metal given to Taxpayer, Taxpayer has presented sufficient information to conclude that the production of other property begins at this point for the nonferrous items, and therefore the items in controversy, to the extent the items are used for nonferrous items, are exempt from sales tax.

Finally, Taxpayer protests several items that were not assigned to specific expense accounts, stating that the items were also used in production. Taxpayer has not provided sufficient information to conclude that those items were used in an exempt manner, and is accordingly denied.

FINDING

Taxpayer's protest is denied with respect to the crane, repair parts for the crane, maintenance parts for the crane and any other items that transport metals that need no further work prior to shredding. Taxpayer's protest is sustained with respect to items that relate to removing nonferrous items from metals and cutting metals it receives, and tangible personal property used on such metals after the removal of nonferrous materials. Taxpayer's protest is denied to items that were not assigned to a specific expense account due to insufficient information.

II. Tax Administration: Negligence Penalty

The Department may impose a ten percent (10%) negligence penalty. IC 6-8.1-10-2.1 and 45 IAC 15-11-2. Taxpayer's failure to timely file income tax returns, generally, will result in penalty assessment. IC 6-8.1-10-2.1(a)(1). The Department, however, may waive this penalty if the taxpayer can establish that its failure to file "was due to reasonable cause and not due to negligence." 45 IAC 15-11-2(c). A taxpayer may demonstrate reasonable cause by showing "that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...." *Id.*

With respect to the penalty, Taxpayer has not provided sufficient information to permit penalty waiver.

FINDING

Taxpayer's protest is denied.

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